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# ***SOUTHWEST RECYCLING, INC.***

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## ***MEMORANDUM***

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DATE: November 13, 1993  
TO: Karl Litz - Latham & Watkins, 701 'B' St #2100, SD, 92101  
FROM: Dan Cotter  
SUBJECT: Ship Dismantling Business Information

### Ship Dismantling Contracts

Enclosed is a copy of the contract and associated terms and conditions for the aircraft carrier 'Bon Homme Richard' which we purchased in 1992.

The contracts for other vessels sold by DRMS are essentially the same except that contracts issued subsequent to the 'Bon Homme Richard' have explicitly disclosed to purchasers that the shipboard cable is contaminated with PCB's.

I am also enclosing the contract award notices for the four ships we have purchased:

Sale #16-1009 - USS Chicago (heavy cruiser)  
Sale #16-1010 - USS Bon Homme Richard (aircraft carrier)  
Sale #16-2003 - USS Morton (destroyer) & USS Barbel (submarine)

### Hazardous Waste Issues

We have identified four key hazardous waste issues where we believe the Government failed to disclose latent defects to potential purchasers. We believe that the Government had knowledge of these defects prior to the sale of the vessels:

- 1) PCB Contaminated Ship Cable - The Government had performed testing of the cable before we purchased any vessels. The tests showed a PCB problem which was not disclosed in the Invitation for Bids.
- 2) Asbestos - The Government performed an asbestos survey on all the vessels being sold. The Invitation For Bids assured purchasers that all compartments containing asbestos had been marked with warning signs. We have found that the surveys failed to detect numerous materials and compartments on the vessel which contained asbestos.

- 3) Bilge Fluids (Chrome Water) - The vessel contracts did disclose the estimated amount of fuel on each vessel which requires disposal. On two of the vessels we have also found tanks which were filled with chrome water (a regulated hazardous waste). The contract did not disclose the tanks which contained chrome water even though we believe that this information was available to the Government.
- 4) Lead - Some of the vessels sold by DRMS (but possibly not all) were painted with a coating which contains high levels of lead. This was not disclosed. The presence of the lead requires a number of additional and expensive safety precautions.

A more detailed discussion of the hazardous waste issues can be found in the enclosed application for extraordinary contractual relief.

### Ship Sales History

I will send you a history of major vessel sales and purchasers in a few days. I am still trying to obtain this.

### Economics of Ship Dismantling

Attached is a schedule showing the financial losses incurred by vessel. We have substantially completed three of the four ships originally purchased. The fourth vessel is the submarine 'Barbel' which has only just started.

These vessels vary greatly in size and therefore it is more relevant to look at the cost per ton amounts rather than the absolute amounts of revenues and expenses. The numbers show that hazardous waste abatement costs have ranged from \$53/ton on the first vessel dismantled to \$72/ton on the most recent vessel. The increase in hazardous waste costs is attributable to two main factors (1) safety precautions taken against lead have been increased as we have gained more information on the hazard, (2) there was more asbestos on the most recent ship.

Production efficiency has improved with each vessel. As a result, the cost returns for the vessel 'Bon Homme Richard' show that the indicated loss is almost the same as the hazardous waste costs.

### Environmental & Safety Agencies

We have has dealings with the following departments and agencies of the federal, state, and local governments:

- 1) Defense Reutilization & Marketing Service (DRMS): Periodically send observers to review our compliance with environmental and safety regulations. In a 1992 compliance visit, their findings resulted in the issuance of a cure notice which required us to buy back shipboard cable previously sold and to treat this material as a hazardous waste.

- 2) Supervisor of Shipbuilding: This is the U.S. Navy's contracting office. Representatives of this office have the responsibility to verify that the vessels are demilitarized in accordance with the terms of the contract. This office also initiated a series of complaints to other government agencies (DRMS, OSHA, and possibly others) which alleged that their employees got sick from breathing smoke at our facility.
- 3) Department of Labor - (FED-OSHA): In June/July 1992 they conducted an inspection which resulted in fines totalling \$ 74,100 for alleged safety violations. They have also investigated wrongful termination claims made by former employees who claimed they were terminated because of their concerns for safety.
- 4) Department of Labor - Wages & Hours: Have investigated us for a wrongful termination claim.
- 5) U.S. Coast Guard: We have been fined by the U.S. Coast Guard for an accidental discharge of oil in the bay. We had spilled about one gallon of oil.
- 6) State of California - (CAL-OSHA): In September/October 1992 they conducted an inspection visit which resulted in fines totalling \$ 274,000 for alleged safety violations.
- 7) South Coast Air Quality District: They are primarily concerned with possible airborne discharges of smoke and other contaminants. SCAQD has investigated us as a proxy for the EPA over a complaint filed by a disgruntled employee.

#### Other Observations

Most of the companies who have purchased vessels during the past two years have the following characteristics:

- a) They have never dismantled a ship before.
- b) They are undercapitalized.

The only major corporation which has purchased a vessel has been Southern Scrap which purchased the vessel "Newport News". Other buyers are largely small organizations operating on a shoestring budget and are probably ignorant of the magnitude of hazardous waste problems. Obviously, when the buyers are financially weak it is more likely that corners will be cut on environmental compliance in order to make ends meet. As our financial data shows, the ship dismantling business simply does not have adequate profit margins to pay for proper disposal of hazardous waste. On the West Coast, Schnitzer Steel and SIMS-LMC Recyclers are two financially sound companies who are experienced in ship dismantling and who have the waterfront facilities required for the venture. These companies chose not to participate in recent ship sales because they were aware of the risks associated with environmental compliance.

The form of the DRMS contract is essentially the same as an "as, where is" sale of surplus property with an additional requirement that the property be demolished. The contract also attempts to shift all responsibility for hazardous waste abatement to the purchaser. It is my understanding that it would be illegal for a commercial business to sell a vessel under the terms of the DRMS contract.

**SOUTHWEST RECYCLING, INC.**  
**Losses From Ship Dismantling Projects**

|                          | Actual<br>Chicago | Actual<br>Morton | Projected<br>BH Richard |
|--------------------------|-------------------|------------------|-------------------------|
|                          | -----             | -----            | -----                   |
| Revenues                 | \$2,983,882       | \$886,615        | \$5,000,000             |
| Costs and Expenses:      |                   |                  |                         |
| Vessel Purchase          | (370,000)         | (76,999)         | (528,726)               |
| Towing & Insurance       | (175,383)         | (139,769)        | (312,928)               |
| Hazardous Waste Removals | (685,763)         | (216,410)        | (1,956,971)             |
| Other Dismantling Costs  | (2,718,812)       | (679,353)        | (3,326,981)             |
| Administration/Interest  | (586,940)         | (174,185)        | (511,734)               |
|                          | -----             | -----            | -----                   |
| Total Costs & Expenses   | (4,536,898)       | (1,286,716)      | (6,637,340)             |
|                          | -----             | -----            | -----                   |
| Total Loss               | (\$1,553,016)     | (\$400,101)      | (\$1,637,340)           |
|                          | =====             | =====            | =====                   |

\* \* \* \* \*

**Per Ton Amounts:**

|                            |         |         |        |
|----------------------------|---------|---------|--------|
| Vessel Weight (gross tons) | 12,900  | 3,500   | 27,000 |
|                            | =====   | =====   | =====  |
| Revenues                   | \$231   | \$253   | \$185  |
| Vessel Purchase            | (29)    | (22)    | (20)   |
| Towing & Insurance         | (14)    | (40)    | (12)   |
| Hazardous Waste Removals   | (53)    | (62)    | (72)   |
| Other Dismantling Costs    | (211)   | (194)   | (123)  |
| Administration/Interest    | (45)    | (50)    | (19)   |
|                            | -----   | -----   | -----  |
| Total Loss                 | (\$120) | (\$114) | (\$61) |
|                            | =====   | =====   | =====  |